

## Planning of Bank Branch Audit

*As the financial year draws to a close, the appointment of branch statutory auditors by various Public and Private Banks starts gaining momentum. In the emerging scenario the role of the bank branch auditors and the need and output of the said audit cannot be undermined. Presently, the Indian banking sector is under tremendous stress in terms of rising NPAs, lack of credit offtake, crunching of the net interest margin, rising frauds, compromise of various IT systems, etc. In such a scenario, the role of the auditors is often called in question and serious doubts are raised about the quality of the audit. In addition to this, the Reserve Bank of India (RBI) is often found to be critical of the role of the auditors and being the sole banking regulator, it has the powers to recommend penal action against the auditors in case of negligence or professional misconduct. The members in the profession need to exercise utmost professional skepticism and be proactively involved in their audits, especially those of the bank branches. In majority of the cases, the auditors do perform their duties with adequate skills and caution, yet are found caught in the mess, primarily due to lack of audit planning and documentation of the work done. Read on...*



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It is with this purpose that planning for a Bank branch audit assumes greater importance. The auditors need to be aware of the entire gamut of Bank branch audit. SA 300 deals with the Planning an Audit of Financial Statements. Appropriate planning is also essential since in terms of SA 600, using the Work of another Auditor, the Statutory Central Auditor is entitled to rely on the work done by the branch auditor. The auditor should also be abreast with the latest version of the Guidance Note on Audit of Banks issued by the Institute (ICAI). The various stages of the Bank branch audits are explained in the following section.

### A. Appointment and Related Formalities

The letter of appointment sent by banks to branch auditors typically contains the following:

1. Appointment under the Banking Regulation Act, 1949, and the underlying duties and responsibilities of the auditors.
2. Particulars of branches allotted to the firm and of the region/zone to which the branch reports.
3. Names and communication details of statutory central auditors.
4. Names and communication details of previous auditors.
5. Guidelines for conducting audit of Branches, completion of audit, eligible audit fees and reimbursement of expenses, etc.
6. Procedural requirements to be complied with in accepting the assignment, e.g., letter of acceptance, declaration of indebtedness, declaration of fidelity and secrecy, other undertaking by the firm/SBA, specimen signatures, etc.
7. Requirements of SA 220, SA 210 w.r.t acceptance/ continuance of the client relationship, compliance with ethical requirement, etc.

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8. Scope of work - Besides the statutory audit under the provisions of the Banking Regulation Act, 1949, the branch auditors are also required to verify certain other areas and issue various report and certificates like the Long Form Audit Report (LFAR), Tax Audit Report, and various certificates.

In present times, the time available for completion of branch audit is extremely limited.

Co-ordination between the auditor and the branch management is essential for an effective audit, timely completion with the highest audit quality. NoC from the previous auditor should be obtained and kept on record. On receipt of NoC and accepting the appointment, the auditor should send a formal communication to the branch management/HO accepting his appointment and other declarations and undertakings so required. An engagement letter should also be sent to the appointing authority of the Bank by the Auditor. For the sake of clarity, the auditor should also specify the books, records, and other information that he would require in the course of his audit. Such a communication would enable the branch management to keep the requisite documents, information, etc., ready in a timely manner. Additionally, a visit to the branches would be helpful prior to actually commencing the audit. It will enable the auditor to get an overall idea about the business, nature and competences of the staff and understanding of the flow of information and authority.

## **B. Knowledge of the Banking Business, Branch Composition and Expected Deliverables.**

The functioning of banking industry in India is regulated by the RBI. The auditors need to understand the role of RBI and the nuances of the banking sector. The provisions regarding the financial statements of banks are governed by the Banking Regulation Act, 1949. Further, in case of banking companies, the requirements of the Companies Act, 2013, relating to the balance sheet, profit and loss account and cash flow statement

**The auditors should also ensure that their audit report complies with the requirements of SA 700 (Revised), SA 705(Revised), and SA 706 (Revised).**

of a company, in so far as they are not inconsistent with the Banking Regulation Act, 1949, also apply to the financial statements, as the case may be, of a banking company. It may be noted that this provision does not apply to Nationalised Banks, State Bank of India, its Subsidiaries and Regional Rural Banks (RRBs).

The provisions regarding audit of Nationalised Banks are governed by the Banking Regulation Act, 1949 and the RBI Guidelines. The provisions regarding audit of Banking Companies are governed by the Banking Regulation Act, 1949, RBI Guidelines and the provisions of the Companies Act, 2013.

The auditors should also ensure that their audit report complies with the requirements of SA 700 (Revised), SA 705(Revised), and SA 706 (Revised).

The audit plan needs to be based on the business mix of that branch. Sample selection is also dependent on the business mix of the branch. Chartered Accountant must discuss the sample size with branch manager based on business mix and percentage of checking mentioned in the appointment letter, if any.

## **C. Composition of the Audit Team and Engagement Team Discussions**

Since branch audit is essentially a time bound program, the audit team must be chosen appropriately. Preferably, staff having prior knowledge of bank audits should be included in the audit team. Persons having good interpretation and analytical skills, report drafting abilities and intuitive capabilities should be given priority. The team should also comprise of suitable Chartered Accountants for guidance and coordination. It is essential that basic training to the branch prior to

actual commencement of the audit is necessary. This includes knowledge of RBI circulars, closing circular of the Bank, proficiency with features of the CBS. Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.

## **D. Basic Understanding of following Reference Material:**

1. RBI Circulars – RBI issues various circulars during the year to be complied by the Banks. Auditors of banks are expected to have knowledge of these circulars. Till the year 2015, RBI had a practice of issuing Master Circulars every year on 1<sup>st</sup> July. Since January 2016, RBI has started issuing Master Directions. Such Master Directions are issued regularly.
2. Closing Circular of the Bank - With the appointment letter, the Closing Circular of the bank is also sent to the Auditors. The said circular covers the policies of concerned bank which are framed within the parameters set by RBI Circulars and also SEBI Guidelines etc. Dates of expected compliance from the branches are also included in the Circular. Accounting treatment of various items is also spelt out in the closing circular.
3. ICAI Guidance Note - The Guidance Note on Audit of Banks is issued by the Auditing and Assurance Standards Board (AASB) of ICAI every year with the objective to provide detailed and updated guidance to the members on various aspects of bank audits. The Guidance Note is an important resource for the members carrying out audits of banks and bank branches. The Guidance Note is updated every year to incorporate the impact of developments that have taken place in the banking sector which require attention of statutory auditors,

such as, master directions/circulars of RBI, other relevant circulars issued by RBI, relevant pronouncements of ICAI having bearing on bank audits, amendments/changes in applicable laws or regulations.

Persons having good interpretation and analytical skills, report drafting abilities and intuitive capabilities should be given priority. The team should also comprise of suitable Chartered Accountants for guidance and coordination.

4. Accounting and Auditing Standards- Auditors need to be aware of and ensure compliance with relevant and applicable Engagement and Quality Control Standards issued by the ICAI (SAs and SQCs).
5. Allied Laws - Auditors should also have basic knowledge of Allied Laws in order to carry out effective audit. For example, Indian Contract Act, 1872, The Bombay Stamp Act, 1958, Negotiable Instruments Act 1881, etc. The impact of provisions under these laws on the documents especially in the area of Loans and Advances need to be considered appropriately, wherever required.

#### **E. Risk Assessment and Internal Control Assessment**

Prior to commencing actual verification of files and documents it is essential for the audit team to conduct risk assessment in terms of SA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment. Banks have certain typical risks viz: handling large volumes of cash on behalf of customers, significant involvement of outsourced services, extensive dependence on IT systems and

software, operations spread over vast geographical areas, etc. SA 315 requires the auditor to put specific emphasis on the risks arising out of the fraud, changes in regulatory environment, complex transactions, related party transactions, and abnormal business transactions.

Since the past few years, cybersecurity has gained much importance. The auditor should familiarise himself with the cybersecurity framework in place at the branch. The audit procedures will need to be enhanced/alterd if the auditor concludes that the cybersecurity framework is not effective.

#### **F. Audit Planning Document**

The engagement partner should summarise audit plan by preparing an audit document also known as the planning memorandum. The planning memorandum should contain the following minimum aspects:

1. Results of the risk assessment procedures performed by the auditor and the extent of sample selection as well as decisions of reliance on controls.
2. The expected scope and extent of the audit procedures to be performed.
3. Any significant changes made during the audit to the overall audit strategy or the audit plan, and the reasons for such changes.

The planning memorandum should also be prepared in a manner that it will act as an aid in the Peer Review process of the Audit Firm.

#### **G. Regular Supervision and Monitoring**

Since branch audit is a time sensitive and time bound activity, regular interaction of the engagement partner with the audit team is imperative. The partner should devote adequate time and attention to critical audit areas like NPA verification, fraud reporting, CRAR certification, etc. Suitable checklists may be devised by the firm to track progress of the work. Requirement and work trackers may also be developed which could be updated on a real-time basis on shared network accessible to all the members of the audit team.

#### **Snapshot of Activities to be exercised during Branch Audit**

##### **At CA's Office, Prior to Commencement:**

1. Refer appointment letter and complete formalities of acceptance, NoC from previous auditor, etc.
2. Identification of audit team and preparation of basic audit programme with standardised checklist. Conduct interactive meeting of the team to confirm understanding of audit programme.
3. Collect and read all relevant background material as stated above.
4. Accounting, Auditing and Assurance Standards, Guidance Notes and other relevant material issued by ICAI be studied.
5. Based on the above, prepare a final check list covering all the areas in Bank Branch Audit and have common understanding of contents of checklist. Please remember that checklist is very important to control Bank Branch Audit in limited time and to cover all the areas under audit.
6. Decide timelines of completion of each job till signing of final report.
7. Draft Management Representation Letter to be obtained from branch manager.
8. Before going for audit, carry with you- all stamps, letterheads, pen drive, soft copies of report formats, reference material, etc.

The Guidance Note on Audit of Banks is issued by the Auditing and Assurance Standards Board (AASB) of ICAI every year with the objective to provide detailed and updated guidance to the members on various aspects of bank audits.

# Bank Audit

## At the Branch, Prior to Commencement:

1. If possible, visit the branch before 31<sup>st</sup> March and discuss broad Audit Programme. Send basic data requirements on e-mail to enable the branch to compile the same. Request for one person to be identified in the Branch as audit coordinator.
2. Discuss all Closing Circulars, Accounting Policies and basic working of the branch with branch manager.
3. Take judgement of records, work culture, procedures, processes, etc. to have an idea of working of the branch.
4. Understand the software used for branch business and CBS system.
5. Verify effectiveness of controls and take list of various exception reports generated by CBS software.
6. Obtain list of all returns and other submissions to be made by branch to HO, ZO, RBI, etc.
7. Obtain copies of all other Audit Reports, i.e., Internal, Revenue, Concurrent, Stock Audit, RBI Inspection, previous year Statutory Auditor's Report, System Audit Report, Discretionary Financial Powers Circular, etc. Also check new advances sanctioned during the year, restructured accounts, new NPAs declared/NPAs upgraded during the year, previous year Memorandum of Changes

(MOCs), list of large borrowers to understand reported irregularities, if any.

8. Attend meeting with Central Statutory Auditors, if scheduled, to understand their expectations and management perspective about Bank Branch Audit.
9. Prepare a list of items to be checked before 31<sup>st</sup> March and after 1<sup>st</sup> April.
10. If possible prepare standardised formats of queries to avoid confusion.
11. Discuss audit of Loans and Advances with Credit Officer in detail and use judgement to decide sample percentage.

## Activities to be exercised During Audit

1. Follow timelines and commitments as decided earlier.
2. Keep track of daily targets. For pendency, verify reasons and take corrective actions. Document the extent of verification.
3. Issues identified by audit staff during the audit may be discussed and cleared on daily basis. However, noting of all observations including those cleared must be preserved as records.
4. Comparative analysis of Balance Sheet and Profit & Loss items with previous year's figures and call for explanations in case of material variances.
5. Plan to check and report aspects

of LFAR to avoid any area to be missed out.

## Activities to be exercised at the End of Audit

1. Carefully review the Audit Process and confirm final Query Sheets and Reports. Re-draft the same if necessary. Involve all team members.
2. Prepare Draft Audit Report and draft of other documents to be certified by you. Discuss the same with Branch. Quantify and discuss MoCs suggested by you.
3. Prepare Final Report.
4. Quantify all points raised in report particularly from the point of view of materiality. This will help in deciding whether a particular comment or observation is necessary to be included in the report.
5. Generate UDIN, separately for the statutory audit report, certificates and the tax audit report. Refer FAQs on UDIN released by ICAI. These can be accessed at <https://udin.icai.org/faqs>
6. Complete other formalities like stamping, signing and affixing date, etc.
7. Handover final sets as required by adhering to the deadline given by bank authorities.
8. Take all your working papers and final set without leaving any of your working papers at Branch. Delete working folders created on branch computer systems before leaving the branch.

## Sample Bank Branch Audit Programme / Illustrative Checklist

S. No.	Name of the person	Designation & Qualifications	Estimated time for work	Initials of the person

## Audit Programme

S. No.	Area of Work	Person responsible at the Branch	Done by whom	Date
A.	General - Pre Audit Work			
1.	Appointment letter, NOC of previous auditor, acceptance letter and related formalities			
2.	Preliminary visit to branch for understanding of business, IT systems etc.			

S. No.	Area of Work	Person responsible at the Branch	Done by whom	Date
3.	Review of Closing Circular issued by Head Office			
4.	Review of Latest available inspection reports of Internal/ Concurrent/Stock Audit/Revenue Audit / RBI / Statutory Auditors/ System Audit and compliance thereof			
5.	Study of Significant accounting policies of the Bank & computer system			
6.	Study of Business mix of the Branch & determination of the sample size and percentage of checking in each area			
7.	Compliance of Mandatory Accounting Standards / Auditing Standards and RBI circulars / directions			
8.	Intimation in writing whether given to the Branch Manager regarding requirements for audit and documents to be kept ready for audit including for LFAR, Tax Audit Report and Certification			
B.	Physical Verification			
1.	Physical verification of Cash (in branch and in ATM), Tokens, Adhesive stamp documents and postage and cross verification of the same with GL balances.			
2.	Physical verification of Investments. (if lodged at Branch)			
3.	Physical verification of valuable stationery like cheque books, Demand Drafts, Pay-Orders etc.			
C.	Verification of Returns and Reconciliation			
1.	Verification of returns submitted to RBI/HO/ZO (Monthly/ Quarterly / Half Yearly / Yearly)			
2.	Verification of Annual Closing Returns			
3.	Verification of HO / Branches / Other Banks Reconciliation, Branch Adjustment Account, Suspense account, Sundry Accounts etc.			
4.	Verification of Statement of Fraud			
5.	Verification of NOSTRO reconciliation			
D.	Verification of Balances			
1.	Checking of opening balances in GL with previous year audited Balance Sheet and Profit & Loss Account			
2.	Cross Verification of Trial Balance, Profit & Loss Account and Balance Sheet figures as on 31 <sup>st</sup> March with GL figures			
E.	Balance Sheet			
1.	Advances 100 % coverage of advances in respect of which outstanding amount is in excess of 5% of the aggregate advances of the branch or ₹ 2 crores whichever is less. List number of cases and names of parties including limits for all cases above specified limits and sample selected below the limit. a) Credit Appraisal			

# Bank Audit

S. No.	Area of Work	Person responsible at the Branch	Done by whom	Date
	b) Sanctioning and Disbursement c) Documentation - Pre-sanction & Post Sanction including Registration and Mortgage of property and Registration of Charges with ROC/ CERSAI d) Monitoring/ Review/ Supervision by the Branch <ol style="list-style-type: none"> <li>i. Submission of financial statements</li> <li>ii. Submission of I.T. Returns</li> <li>iii. Timely submission of stock statements</li> <li>iv. Calculation of Drawing Power</li> <li>v. Inspection of Godowns / other units of the borrowers</li> <li>vi. Operations in the account - overdue/ sticky accounts / diversion of funds/ cheques duly honoured / limit not exceeded frequently</li> <li>vii. Renewal of documents due / Review of Term Loans</li> <li>viii. Penal interest for default – whether system driven or manual</li> <li>ix. Insurance coverage</li> <li>x. Verification of data in CBS with special reference to BASEL II requirements of LTV ratio in case of housing loans etc. / BASEL III Norms</li> </ol>			
2.	Analysis of entries outstanding in Sundries and Suspense Account, Sundry Debtors, Sundry Creditors			
3.	<ol style="list-style-type: none"> <li>i. Verification of assets classified as NPA.</li> <li>ii. Verification of Upgraded Accounts earlier classified as NPA – Registration of uncharged interest</li> <li>iii. Identification of new NPAs</li> </ol>			
4.	Review of suit filed accounts / Decreed accounts & their follow – up			
5.	Checking of additions, deductions, transfer of fixed assets with relevant supporting			
6.	Verify that all balances are shown under proper heads			
7.	Verify that credit balances in OD, CC, inoperative current accounts are not netted off with advances and are shown separately under demand deposits			
	Verify that Interest accrued but not due on loans is not included in advances			
8.	Deposits <ol style="list-style-type: none"> <li>i. Near the Balance Sheet date &amp; till the date of audit whether there have been any unusual large movements in the aggregate deposits held at the year end</li> <li>ii. Verification of Staff Accounts</li> <li>iii. Check that guidelines issued by RBI for inoperative &amp; dormant accounts are strictly followed with KYC guidelines.</li> <li>iv. Verify that overdue, matured time deposits are shown in demand deposits</li> <li>v. Verify that interest accrued but not due is not included in deposits but shown under other liabilities</li> <li>vi. Verify that Dormant Accounts more than 10 years are transferred to Depositors Education and Awareness Fund</li> </ol>			
9.	Analysis of entries outstanding in Bills Payable/ Sundry Deposits, etc.			

S. No.	Area of Work	Person responsible at the Branch	Done by whom	Date
10.	Obtain list of contingent liabilities not acknowledged as debts by the branch. Check for correct reporting.			
F.	Profit & Loss Account			
1.	Verification of provision of interest on standard, substandard, doubtful & loss assets and appropriate accounting treatment thereof and reversal of interest and charges not recovered on new NPAs			
2.	Checking of proper classification of revenue and expenditure items			
3.	Ratio Analysis and comparison with previous year figures			
4.	Verify whether there is any divergent trend in major items of income & expenditure and analysis of reasons thereof			
5.	Test checking of interest on deposits and advances			
6.	Test checking of commission and discount on bills, etc.			
7.	Verification of accounts of major heads of income & expenditure			
8.	Verification of provisions for prepaid and outstanding income & expenditure			
9.	Verification of locker rent received and due and provision thereof			
10.	Verification of provision for depreciation on fixed assets			
11.	Checking of prior period expenses and income and provisioning thereof. Separate prior period expenses and provisioning- give separate numbers			
12.	Checking of provisions for ECGC/ DICGC claims			
G.	LFAR			
1.	Checking of items as per LFAR checklist			
2.	Preparation of annexures to LFAR			
3.	Annexures to LFAR			
4.	NPAs			
H.	Tax Audit Report			
1.	Check the followings in detail-			
2.	Payments made to clubs			
3.	Details of revenue expenditure capitalised			
4.	Whether TDS has been deducted and remitted before the due date			
5.	Particulars of Income and Expenditure of earlier years debited / credited to Profit & Loss Account which are of material nature			
6.	Checking of Tax Audit Schedules			
7.	Preparation of Tax Audit Report			
I.	Verification of Checklist of Jilani Committee Recommendations			
J.	Verification of Checklist of Ghosh Committee Recommendations			
K.	Collection of following certificates and statements from Branch			
1.	Physical verification of cash			

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S. No.	Area of Work	Person responsible at the Branch	Done by whom	Date
2.	Physical verification of Adhesive Stamp Documents, Postage, Security, etc.			
3.	Physical verification of Investments			
4.	Physical verification of Fixed Assets carried out by Branch			
5.	NPA Statement, Profit & Loss Account, Balance Sheet, Trial Balance certified by Branch Manager			
6.	Management Representation Letter			
7.	Certificate from Branch Manager for attendance of Audit			
L.	Issue of Certificates			
1.	Certificate for Review of Loan Portfolio			
2.	Certificate relating to recoveries in claim paid accounts under small loan Guarantee Scheme 1971 and Small Loan (SSI) Guarantee Scheme, 1981			
3.	Certificate in respect of subsidy utilised under the scheme Prime Minister's Rojgar Yojana (PMRY) and correctness of claim made			
4.	Certificate regarding the implementation of Jilani & Ghosh Committee recommendations			
5.	Certificate in respect of Interest Subvention if any at the Branch.			
6.	Certificate regarding possession of investment documents on behalf of Head Office			
7.	Certificate for DICGC Claim			
8.	Movement of NPAs			
9.	Certificate of BASEL – III			
10.	Cash Balance on Twelve Days (Certificate for CRR)			
M.	Finalisation			
1.	Preparation of Draft of the following-			
2.	Audit Report under SA 700 format			
3.	LFAR & Annexures			
4.	Tax Audit Report			
5.	Jilani Committee Recommendations			
6.	Ghosh Committee Recommendations			
7.	Memorandum of Changes			
8.	Discussion of Draft Report with Branch Manager			
9.	Preparation of Final Report			
10.	Generation of UDIN as required by ICAI – separate for Statutory Audit report, tax audit report and certificates			
11.	Submission of Final Report along with Copies of Signed Balance Sheet, Profit & Loss Account and certificates			
N.	Review of work done by Audit Team			
1.	Senior			
2.	Junior			
3.	Articled Clerks			
4.	Employee			